Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	
Federal-State Joint Board on Universal Service	CC Docket No. 96-45
Revised Methodology for Determining Universal Service Support for Non-Rural Carriers	CC Docket No. 97-160 DA 98-715

REPLY COMMENTS OF THE AD HOC TELECOMMUNICATIONS USERS COMMITTEE

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SUMMARY

None of the proposals presently before the Commission for modifying the universal service support methodology would, if adopted, represent an improvement over the methodology the Commission adopted in its May 7, 1998 Report and Order. The Commission's original methodology, when viewed in its entirety, is superior to any of the counterproposals.

The same can not be said for some of the Commission's assumptions regarding universal service. For example, the Commission should re-examine its statement in the *Report to Congress* that it intended to work to ensure that levels of universal service support do not fall below today's levels. Such a goal is inconsistent with the requirements of Section 254 of the Communications Act, and would only perpetuate an economically inefficient, subsidy-laden system.

The Commission should also re-iterate that allowing incumbent local exchange carriers ("ILECs") to recover their embedded costs would harm local competition and ultimately consumers. ILECs already more than recover their costs through revenues from their local and other intrastate services, not to mention their interstate access revenues.

As explicit subsidies replace implicit ones, the Commission should require ILECs to reduce their interstate access charges dollar-for-dollar to reflect any increase in the level of explicit universal service support they receive. Such reductions would not constitute an unconstitutional taking, as GTE has asserted, since access rates are currently set so far above cost. The Commission should reject the self-serving proposals of GTE, BellSouth, and the SBC LECs that the

universal service program include not only explicit support but compensation for implicit subsidies once buried in access charges. Access charges should be cost-based with an allowance for a reasonable profit -- not the windfall the ILECs are currently reaping.

The Commission and the states should recognize that economically efficient pricing will occur only if rates are rebalanced and priced closer to cost. The mere fact that such rebalancing may be politically unpopular does not justify the perpetuation of an economically inefficient universal service program. Moreover, support levels should be targeted to low-income subscribers, not broad low-income geographic areas. Subsidizing wealthy subscribers in remote areas will not advance the goals of universal service.

Finally, carriers that contribute to universal service should be *permitted,* but not *required,* to include a line item on customers' bills indicating the portion of the bill that represents the carriers' contributions to universal service. Requiring such a line item would deprive carriers of the option whether or not to pass through universal service contributions to their customers. Carriers that are parties to service agreements should not have the option of passing through their universal service contributions to their customers -- unless the service agreements specifically permit such a pass-through or the customers otherwise agree. There is no basis in state contract law, the Commission's own precedent, or principles of fundamental fairness to permit carriers unilaterally to abrogate contractual commitments to recover their universal service contributions; therefore, the Commission should clarify (by recanting) its statement in the May 7

Report and Order that carriers may do so.

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The Ad Hoc Telecommunications Users Committee ("Ad Hoc" or the "Ad Hoc Committee") submits these Reply Comments in response to comments filed pursuant to the April 15, 1998 *Public Notice,* DA 98-715 (the "*Public Notice*"). For the reasons set forth below, the Commission should reject all of the self-serving proposals that have been submitted for revising the universal service support methodology described in the May 7, 1997 Report and Order.[1] Many of those proposals are little more than thinly disguised attempts to get a second chance at reconsideration.

Section 254(b)(5) of the Communications Act[2] requires regulators to make

[1] *Federal-State Joint Board on Universal Service,* CC Dkt. No. 96-45, Report and Order, 12 FCC Rcd 8776 (1997) ("Report and Order") (subsequent history omitted).

[2] 47 U.S.C. § 254(b)(5).

implicit subsidies explicit, and the Commission has already taken significant strides toward satisfying that requirement with respect to the rates it regulates. Most of the work remaining to be done is on the state level. The Commission's high-cost and low-income funding requirements as determined by the existing rules are now collected via an explicit surcharge on carrier revenues. Subsidies previously collected through FCC-regulated carrier common line charges ("CCLCs") and Interconnection Charges ("ICs") are being phased out and an explicit contribution element -- the PICC -- is being phased in. To the extent that other implicit subsidies remain, they are primarily found in state-regulated prices and, as described below, should be collected through state-directed rate rebalancing efforts -- not through increases in federal universal service fund collections.

Although it was not perfect,[3] the Commission's original methodology is superior to any of the proposals that have been advanced for revising that methodology. There is no good reason to replace the Commission's original methodology with any of those currently under consideration.

While wholesale abandonment of its original methodology for calculating universal service support is unwarranted, the Commission should take this opportunity to re-examine some of the fundamental assumptions it embraced

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[3] For example, as the Ad Hoc Committee argued in its first round of comments in this proceeding, and again in its comments filed May 26, 1998, the Commission should have included revenues the local exchange carriers ("LECs") receive from yellow pages advertising in calculating the revenue benchmark.

both in the Report and Order and since.[4] First, the Commission should reconsider its recent statements that it intends to ensure that levels of universal service support will never fall below today's support levels.[5] Second, the Commission should acknowledge and address the fact that a universal service support program that allows incumbent LECs ("ILECs") to recover their embedded costs erects economic barriers to the development of competition in the local exchange and exchange access markets. Third, each LEC should be required to reduce its interstate access charges dollar-for-dollar at least to levels that reflect any increase in the level of universal service support it receives. Fourth, the Commission should acknowledge that economically efficient universal service support can only be achieved through rate rebalancing, and it should encourage the states to embark on such a course. Finally, although contributors to universal service should be *permitted* to identify their contributions as a separate line item on customers' bills should the carriers choose to pass those contributions through, they should not be *required* to pass through their contributions. Indeed, they should be prohibited from doing so when they have service agreements with customers unless those agreements

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4 Inasmuch as many of the parties that have submitted proposals and/or comments in response to the *Public Notice* apparently do not feel constrained to limit their submissions to the issues raised therein, these Reply Comments are similarly liberal in scope.

5 *Federal-State Joint Board on Universal Service,* CC Dkt. No. 96-45, Report to Congress, FCC 98-67 (released April 10, 1998) ("*Report to Congress*") at ¶¶ 197, 219.

expressly allow the carriers to pass through such charges or the customers otherwise expressly agree thereto.

I. MAINTENANCE OF EXISTING LEVELS OF UNIVERSAL SERVICE SUPPORT SHOULD NOT BE A GOAL UNTO ITSELF.

In its recent *Report to Congress* in this docket, the Commission stated, "Just as collecting insufficient support would threaten the availability of universal service, collecting more support than necessary would increase rates for all subscribers, creating a similar threat to universal service principles."[6] The Commission cautioned that "only the minimum amount of support necessary to achieve the statutory goals [of universal service] should be collected."[7] Notwithstanding this admonition, the Commission stated that it intends to work to ensure that levels of universal service support will never fall below today's support levels.[8] The goal of maintaining existing levels of universal service support is not embodied in Section 254 of the Act, and it would run contrary to Section 254's requirements. Pursuing such a policy would enshrine a system that is bloated with implicit subsidies and burdened by economic inefficiencies.[9] The Commission should not lose sight of the fact that just a year before passage of the 1996 Act, it began its own investigation into the growth in the universal service funding requirements with a stated goal of shrinking subsidy levels that

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6 *Id.* at ¶ 229.

7 *Id.*

8 *Id.* at ¶¶ 197, 219.

9 MCI agrees with Ad Hoc's position in this regard. *See* MCI Comments in CC Dkts. Nos. 96-45 and 97-160 (filed May 15, 1998) at 24, n.27.

had been growing out of control for some time.[10]

In the more than two years since enactment of the 1996 Act, meaningful competition in the market for local services remains as elusive as ever.[11] At the same time, there is no current threat to the maintenance of universal service, but the prospect of expanded burdens on new entrants for additional universal service support cannot help but further frustrate efforts at entry. Proposals being considered by the Commission that would maintain existing subsidy levels[12] would force entrants to subsidize incumbents, while providing no demonstrable gain in affordability or overall residential penetration.

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10 *Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board,* CC Dkt. No. 80-286, Notice of Inquiry 9 FCC Rcd 7404 (1994).

11 The Survey of Local Competition conducted by the Common Carrier Bureau earlier this year underscores the continuing ILEC dominance and almost negligible competitive penetration of the local exchange and interstate access markets. Common Carrier Bureau, Survey of State of Local Competition (FCC website March 27, 1998) (www.fcc.gov\ccb\local_competition\survey\responses). Similarly, in a recent Further Notice of Proposed Rulemaking, the Commission acknowledged that "BOCs remain the dominant providers of local exchange and exchange access services in their in-region states . . . ." *Computer III Further Remand Proceedings: Bell Operating Company Provision of Enhanced Services*, CC Docket No. 95-20, and *1998 Biennial Regulatory Review – Review of Computer III Safeguards and Requirements,* CC Docket No. 98-10, Further Notice of Proposed Rulemaking, FCC 98-8 (released January 30, 1998) at ¶ 51 (footnote omitted). The Commission noted that the BOCs account for approximately 99.1 percent of the local service revenues in their markets. *Id.* at note 151.

12 *E.g.,* Proposal of GTE in CC Dkts. Nos. 96-45 and 97-160 (DA 98-715) (filed April 27, 1998) ("GTE Proposal ") at 11-14; Comments and Proposal of BellSouth Corporation in CC Dkts. Nos. 96-45 and 97-160 (DA 98-715) (filed April 27, 1998) ("BellSouth Proposal") at 3 & n.8; Letter from Peter Blum, Vermont Public Service Board, to Magalie Roman Salas, FCC, (April 10, 1998), revised April 27, 1998 ("Ad Hoc Working Group Proposal") (advocating "hold harmless" support set at existing levels of federal support). The Ad Hoc Working Group and the Ad Hoc Telecommunications Users Committee are not affiliated in any way. In its Comments, AT&T has erroneously attributed to the Ad Hoc Telecommunications Users Committee a position that the Ad Hoc Committee has not taken. AT&T Comments in CC Dkts. Nos. 96-45 and 97-160 (DA 98-715) (filed May 15, 1998) ("AT&T Comments") at 13-15. It appears from AT&T's citations that AT&T should have attributed the position to the Ad Hoc Working Group. *See* AT&T Comments at 15 (citing discussion of Ad Hoc Working Group Proposal in *Public Notice* at 5-6).

II. ALLOWING ILECS TO RECOVER THEIR EMBEDDED COSTS IS INCONSISTENT WITH THE PRINCIPLE OF COMPETITIVE NEUTRALITY AND IS UNNECESSARY BECAUSE ILECS ARE ALREADY RECOVERING THOSE COSTS.

To the extent possible, the universal service program should be administered in a competitively neutral manner, *i.e.*, both the assessment of contributions and distribution of support should be administered with competitive neutrality.[13] However, to the extent that new entrants are forced to subsidize incumbent carriers, competition in the local exchange and exchange access markets will never realize its potential. Thus, viewing ILECs' recovery of embedded costs as some sort of entitlement is inconsistent with the competitive neutrality objectives of the Telecommunications Act of 1996,[14] and is neither necessary nor appropriate as a means for assuring affordability or the continued maintenance of universal service.

Unfortunately, numerous ILEC commenters -- notably GTE, BellSouth, and the SBC LECs -- parrot the same ill-conceived notion that universal service subsidies under a purportedly reformed system should equal subsidy levels produced by today's system for subsidizing high-cost service areas.[15] To the extent that such a policy has the effect of limiting competition and/or increasing entrants' costs, consumer prices will increase and the price-constraining benefits expected from competition in the local exchange market will be denied. Rather than

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13 *See* MCI Comments in CC Dkts. Nos. 96-45 and 97-160 (DA 98-715) (filed May 15, 1998) ("MCI Comments") at 11-12.

14 *See* S. Rep. No. 230, 104th Cong., 2d Sess. 131 (1996) ("Joint Explanatory Statement") at 113.

15 *See* Comments of GTE at 2-3; Comments of BellSouth at 1; Comments of SBC at 4.

supporting the Act's universal service goals, policies that seek to assure incumbents full recovery of their embedded costs irrespective of the success of competitors in attracting customers can only work to frustrate and undermine Congress' and the Commission's objectives.

Not only do embedded costs reflect past engineering and procurement choices that will likely have little relevance in the current and future market environments,[16] but embedded costs are also distorted and bloated by investment decisions that were either made under rate-of-return regulation and/or motivated by ILEC business strategies that focused on providing costly, advanced services and on achieving strategic market positioning goals rather than on meeting universal service objectives.[17] Lasting, meaningful competition cannot, and will not, develop if ILECs are allowed to extract federally mandated insurance against potential future competitive losses in the form of a guarantee of full recovery of their embedded costs.

The proposals of GTE and other ILECs that actual costs be used to

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16 *See* Lee L. Selwyn and Patricia Kravtin, *Analysis of Incumbent LECs: An Empirical Perspective on the "Gap" between Historic Costs and Forward-Looking TSLRIC,* submitted in FCC CC Docket 96-98, May 30, 1996 (as Appendix C, Attachment C of AT&T Reply Comments in CC Dkt. No. 96-98).

17 *Id.* Because ILECs were insulated from investment risks by rate-of-return regulation, and because aggregate earnings were a function of aggregate net investment, rate-of-return ILECs had strong incentives to overinvest in their capital asset base. *See* Averch, Harvey and Johnson, Leland, "Behavior of the Firm under Regulatory Constraint," *American Economic Review*, Volume 52, No. 5, 1962. *See also* California PUC, Consolidated Dockets Nos. I.87-11-033, *et al.*, and A.87-01-002, *Re: Alternative Regulatory Frameworks for Local Exchange Carriers*, Decision 89-10-031, October 12, 1989, 33 CPUC 2d 43, at 44; *In the Matter of Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, *Second Report and Order*, October 4, 1990, at 15.

calculate universal service funding requirements[18] should therefore be rejected. These attempts to recover the ILECs' embedded costs would, if successful, further retard the already stunted development of local competition.[19] Moreover, as AT&T has pointed out, the major non-rural ILECs do not need additional support to provide universal service: their revenues from local and other intrastate services alone -- not including access revenues -- *exceed* their forward-looking costs of providing universal service by an aggregate $23 billion.[20] And the implicit support that is built into interstate access rates is pure profit.[21]

The historic role of high-margin services such as yellow pages advertising, vertical service features, and other non-basic offerings is to enable ILECs to recover fully their embedded costs. Yet in many states, revenues from yellow pages, and in some cases certain optional (or "discretionary") services, no longer flow to support basic service, but are diverted partially or entirely to shareholders. Incumbents should not be permitted to receive universal service subsidies from their would-be local service rivals while remaining free to divert their own sources of potential support directly to the bottom line. At a minimum,

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[18] GTE Proposal at 9; BellSouth Proposal at 3 & n.8 (universal service fund should include current explicit support levels plus compensation for ILECs' "legacy costs" currently recovered implicitly through carrier common line charges and primary interexchange carrier charges); Comments of Southwestern Bell Telephone Company, Pacific Bell, and Nevada Bell on Alternative Methodologies in CC Dkts. Nos. 96-45 and 97-160 (DA 98-715) (filed May 15, 1998) ("SBC LECs' Comments") at 3-4 (universal service fund should replace implicit subsidies and cost of universal service should be based on "actual, booked costs").

[19] *See* MCI Comments at 12.

[20] *See* AT&T Comments at 5-7.

incumbents should not be provided any net universal service funding until all such internally-generated contribution sources are fully committed to this purpose.

III. ACCESS CHARGES SHOULD BE REDUCED IN PROPORTION TO UNIVERSAL SERVICE SUPPORT.

As MCI and others have recommended in their comments, ILECs should be required to reduce their access charges to reflect the federal universal service support they receive.[22] Moreover, the "downstream" carriers and customers who bear the burden of making the contributions should reap the benefits of any offsetting reductions in implicit subsidies, as MCI has proposed.[23] Therefore, to the extent that interexchange carriers and their customers fund the explicit universal service fund subsidies, access charges that those carriers and their customers pay should be reduced commensurately, on a dollar-for-dollar basis, through an exogenous cost change.[24]

In this regard, the proposals of GTE and BellSouth are particularly egregious in that they recommend an oversized universal service program that would permit ILECs to recover implicit subsidies foregone as a result of access charge reform![25] Congress did not intend the overhauled universal service

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21 *Id.* at 5-6 & n. 3.

22 *See* MCI Comments at 8-9; AT&T Comments at 8; Comments of Sprint Corporation in CC Dkts. Nos. 96-45 and 97-160 (DA 98-715) (filed May 15, 1998) ("Sprint Comments") at 1.

23 MCI Comments at 9.

24 *See* 47 C.F.R. §§ 61.45(d)(1)(iv); 61.45(d)(3).

25 *See* GTE Proposal at 14-15 (support should include explicit subsidies as well as compensation for all implicit subsidies previously included in access charges); BellSouth

program to become a source of excessive ILEC subsidies, but instead stated that universal service support should merely be "sufficient . . . to preserve and advance universal service."[26]

GTE's claim that ILECs would suffer an unconstitutional taking if universal service support (or some other mechanism) does not compensate them for the implicit subsidies they receive through interstate access charges -- in addition to providing explicit support[27] -- is unsupported and should be discounted. As noted above, the ILECs more than recover their embedded costs through revenues from their basic and discretionary services. Their interstate access service rates should be cost-based, with an allowance for a reasonable profit, based on the economic risk they face in providing access services.[28] Current access rates are widely acknowledged to be far above such levels; therefore, a reduction in such rates would not result in an unconstitutional "taking" of ILEC property.

IV. AN ECONOMICALLY RATIONAL UNIVERSAL SERVICE PROGRAM BEGINS WITH RATE REBALANCING.

The universal service support program will never be economically rational, and competition will never reach its full potential, until LECs' rates are rebalanced to more closely reflect underlying costs. Bell Atlantic recognized the

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Proposal at 3 (support should cover explicit subsidies and implicit subsidies contained in CCLC and PICC); *see also* AT&T Comments at 20; MCI Comments at 19.

26 47 U.S.C. § 254(b)(5).

27 GTE Proposal at 11, 20.

28 *See Duquesne Light Co. v. Barasch,* 488 U.S. 299 (1989) at 310.

importance of rate rebalancing to a competitive neutral universal service mechanism when it pointed out that a federal-only universal service system "leaves no role for state action and penalizes customers in those states that have rebalanced their local service rates to bring them closer to cost."[29] And at least one other ILEC has acknowledged the importance of rate rebalancing to the development and growth of a competitive marketplace.[30] Richard C. Notebaert, Chairman and CEO of Ameritech Corp., has recognized that rate rebalancing has not yet occurred on any meaningful scale because it would be politically unpopular.[31] The Commission should not adopt uneconomic support mechanisms because some jurisdictions wish to avoid rate rebalancing. Old rate structures are not compatible with competitive telecommunications markets.

The Commission should more carefully consider affordability of telephone service among subscribers in high-income, high-cost areas when calculating universal service support requirements of LECs serving such areas. Time Warner Communications Holdings Inc. has advanced a compelling proposal in this regard.[32] Subsidization of services furnished to wealthy subscribers does not advance any universal service goal, but does serve to frustrate entry and

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29 *See* Comments of Bell Atlantic in CC Dkts. Nos. 96-45 and 96-170 (DA 98-715) (filed May 15, 1998) ("Bell Atlantic Comments") at 4.

30 *See* report of remarks by Richard C. Notebaert, Chairman and CEO of Ameritech Corp., reported in "Notebaert: Stop 'Dancing Around' Rate Rebalancing Issues," Telecommunications Reports (May 25, 1998) at 13.

31 *Id.*

32 Comments Regarding Universal Service Methodology of Time Warner Communications Holdings Inc., in CC Dkts. Nos. 96-45 and 97-160 (DA 98-715) (filed April 27, 1998).

protect incumbents' markets by increasing entrants' costs. Section 254(b)(5) unequivocally requires that subsidies be made explicit; policies that flow universal service support to high-income communities must not be camouflaged in broad averages that ignore significant variations in "affordability" that prevail across the full spectrum of income levels.[33]

V. UNIVERSAL SERVICE CONTRIBUTORS SHOULD BE PERMITTED, BUT NOT REQUIRED, TO IDENTIFY UNIVERSAL SERVICE CONTRIBUTIONS ON CUSTOMERS' BILLS, SUBJECT TO COMPLIANCE WITH CONTRACTUAL COMMITMENTS.

Various commenters have proposed that the Commission either permit or require carriers to identify their contributions to universal service support as a separate line item on their customer invoices.[34] Although a specific line item would enhance the accountability of the universal service support program, and therefore be socially desirable, the Commission should not *mandate* such a line item, since such a mandate would be tantamount to requiring carriers to pass through their universal service contributions. Absent such a requirement, carriers would retain the option of not passing through their contributions.

ILECs can collect universal service support either from their wholesale interexchange carrier access customers in the form of per-line charges, or from the ILECs' own retail service customers. They should not be permitted to collect support from both sources. Accordingly, if the ILECs collect universal service support from their retail customers, the cost of such support that had been built

33 *See also* Comments of Sprint at 7-9.

34 *See, e.g.,* Comments of MCI at iii, 10.

into interstate access charges should be removed. End users of the ILECs' local services (who are also indirect purchasers of their interstate access services) should realize a net flow-through, *i.e.*, carriers should not be permitted to pass through increased costs resulting from new or increased universal service contributions unless they are also required to pass through savings resulting from the elimination of implicit subsidies, *e.g.*, in the form of access charge reductions.

Moreover, the Commission should not permit any carrier unilaterally to pass through its universal service contributions to customers with whom it has service contracts *unless* the terms of those contracts permit such a pass-through or a customer otherwise expressly agrees to it. The Commission should clarify (by recanting) its earlier statement in the Report and Order that carriers should be permitted to abrogate their service arrangements with customers to recover their universal service contributions.

As the Ad Hoc Committee stated in its pending Petition for Reconsideration of the Report and Order,[35] basic principles of state contract law, the Commission's own precedent,[36] and fundamental fairness all run contrary to

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[35] Petition of the Ad Hoc Telecommunications Users Committee for Partial Reconsideration and Clarification of Report and Order in CC Dkt. No. 96-45 (filed July 17, 1997) at 2-10.

[36] *See* Tariff *Filing Requirements for Nondominant Common Carriers*, Order, 10 FCC Rcd 13653 at ¶¶ 12-16 & n.35 (1995); *RCA American Communications, Revisions to Tariff FCC Nos. 1 and 2*, Memorandum Opinion and Order, 84 FCC 2d 353, 358 (1981); 86 FCC 2d 1197, 1201(1981); 2 FCC Rcd 2363 (1987) (collectively, "*RCA Americom* Orders"), *aff'd sub nom. Showtime Networks, Inc., v. FCC*, 932 F.2d 1 (D.C. Cir. 1991); *see AT&T Communications Contract Tariff No. 360*, Order Designating Issues for Investigation, 10 FCC Rcd 11031 at 11032-35 (1995) (all requiring showing of substantial cause before carrier can raise rates in long-term service plans, and then only upon showing of highly unusual and unforeseeable circumstances).

allowing carriers unilaterally to abrogate customer contracts to adjust rates to reflect universal service contributions contradicts.

Under New York State contract law, for example,[37] an individual party "may not abrogate a contract unilaterally merely by showing it would be financially disadvantageous to perform it."[38] This rule has consistently been applied where the government renders performance of a contract less profitable.[39] If -- as was the case with most telecommunications agreements in effect when the Commission issued the Report and Order -- a governmental action is *foreseeable* at the time parties assume their contractual obligations, then unilateral abrogation by either party will be impermissible, *even if one of the contracting parties becomes bankrupt* as a result of being required to perform its

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[37] Other states follow the general rule that applies in New York. *See, e.g., Cutter Laboratories, Inc. v. Twining,* 34 Cal.Rptr. 317, 324 (Dist. Ct. App. 1963); *Standard Iron Works v. Globe Jewelry & Loan, Inc.,* 167 C.A.2d 108, 118; 330 P.2d 271 (Dist. Ct. App. 1958); *Rose v. Long,* 128 C.A.2d 824, 827; 275 P.2d 925 (Dist. Ct. App. 1954); *Consolidated Laboratories Inc. v. Shandon Scientific Co.,* 413 F.2d 208, 212 (7th Cir. 1969) (applying Illinois law); *Valtrol Inc. v. General Contractors Corp.,* 884 F.2d 149, 153-154 (4th Cir. 1989) (applying Texas law); *Measday v. Kwik Kopy Corp.,* 713 F.2d 118, 126 (5th Cir. 1983) (applying Texas law).

[38] *A.W. Fiur Co. v. Ataka and Co.,* 422 N.Y.S.2d 419, 423 (A.D. 1979); *see also 407 E. 61st Garage, Inc. v. Savoy 5th Ave. Corp.,* 23 N.Y.2d 275, 282 (1968); *Rockwell v. Knights Templars & Masonic Mut. Aid Assn.,* 119 N.Y.S. 515, 518-519 (A.D. 1909) ("[i]t is repugnant to the idea of a contract that one of the parties may, at his election, from time to time change the amounts which he is to receive from the other party. . . . The fact that a contract proves unprofitable...is no reason why the courts can permit the party who has made such an unwise contract to change its terms at will and make for itself a more profitable contract.").

[39] *Coastal Power Production Co. v. New York State Public Service Commission,* 551 N.Y.S.2d 354, 356 (A.D. 1990) ("'[t]he fact that a contract becomes increasingly difficult and expensive to perform because of a law enacted after its execution does not excuse performance'") (quoting 22 NYJur2d, Contracts, § 355). *See Sullivan County Harness Racing Assn. v. City of Schenectady Off-Track Betting Commission,* 351 N.Y.S.2d 56, 60 (Sup. Ct. 1973) ("performance is *never* excused by changes in the law, particularly when the law was in existence when the contract was made and the changes were foreseeable") (emphasis added). *See also Reetz, Inc. v. Stackler,* 201 N.Y.S.2d 54, 57 (Sup. Ct. 1960).

obligations.[40] And even if something -- including a governmental order -- is *unforeseeable* at the time parties enter into a contract, performance will be "excused only in extreme circumstances,"[41] *i.e.,* the order renders performance of the contract impossible or illegal.[42] Here, because implementation of Section 254's overhaul of the universal service program was foreseeable for any carrier that entered into a telecommunications service agreement at least between 1994[43] and 1997 -- if not before -- the mere fact that carriers' costs will increase as a result of universal service reform is insufficient to allow them unilaterally to adjust their contract rates to include universal service contributions.

Moreover, merely allowing carriers to increase their rates to reflect universal service contributions would ignore the net effect of the three orders the Commission adopted on May 7, 1997,[44] which many believe will be that the cost

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40 *A&S Transportation Co. v. County of Nassau,* 546 N.Y.S.2d 109, 111 (A.D. 1989) ("when a governmental action is foreseeable, a contractor may not invoke "impossibility" to excuse performance"). *Stasyszyn v. Sutton East Associates,* 555 N.Y.S.2d 297, 299 (A.D. 1990) ("the law is well-established that economic inability to perform contractual obligations, even to the extent of insolvency or bankruptcy, is simply not a valid basis for excusing compliance"). *See also 407 E. 61st Garage, Inc. v. Savoy 5th Ave. Corp.,* 23 N.Y.2d 275, 281-82 (1968).

41 *Kel Kim Corp. v. Central Markets Inc.,* 524 N.Y.S.2d 384, 385 (N.Y. 1987); *see also J.J. Casone Bakery, Inc. v. Edison Co. of New York,* 638 N.Y.S.2d 898 (Sup. Ct. 1996).

42 *See Flaster v. Seaboard Garage Corp.,* 61 N.Y.S.2d 152, 155 (Sup. Ct. 1946); *Doherty v. Monroe Eckstein Brewing Co,* 187 N.Y.S. 633, 635 (Sup. Ct. 1921).

43 Passage of the 1996 Act took two years. In June of 1994, the House of Representatives overwhelmingly passed two bills—the Antitrust Communications Reform Act (H.R. 3626) and the Communications Competition and Information Infrastructure Reform Act (H.R. 3636)—after extensive hearings throughout 1993 and early 1994. Similarly, the Senate passed the Communications Act of 1994 (S. 1822) in August of 1994. All three pieces of legislation were precursors to the 1996 Act. Knauer, Machtley, Lynch. *Telecommunications Handbook: A Complete Reference for Business.* Chapter 1: Legislative History of the Telecommunications Act of 1996. (Government Institutes, 1996).

44 Report and Order; *Access Charge Reform,* First Report and Order, CC Dkt. No. 96-262, FCC 97-158 (released May 16, 1997); *Price Cap Performance Review for Local Exchange*

of serving large users of telecommunications services will decrease. But if the Commission *does* allow carriers to increase their contracted rates to recover universal service contributions, fairness dictates that the Commission also permit the customers of those carriers to take a "fresh look" at their contractual arrangements in light of such action.

CONCLUSION

For the foregoing reasons, the Commission should reject all of the pending proposals for modifying the original universal service support methodology.

Respectfully submitted,

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Carriers, Fourth Report and Order, CC Dkt. No. 94-1, 12 FCC Rcd 16,642 (released May 21, 1997).

Certificate of Service

I, Molly A. McEwan, hereby certify that true and correct copies of the preceding Reply Comments of the Ad Hoc Telecommunications Users Committee in CC Docket Nos. 96-45 and 97-160 (DA 98-715) were served this 29th day of May, 1998 via hand delivery or first-class mail upon the following parties:

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